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UNCLAS SECTION 01 OF 02 GUANGZHOU 000437

SENSITIVE
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STATE FOR EAP/CM
STATE PASS USTR CHINA OFFICE

E.O. 12958: N/A
TAGS: ETRD EIND ELAB ECON PGOV CH
SUBJECT: A Lighter Coat of Varnish: PRD Furniture Manufacturers
Struggle in a Transitioning Industry

REF: A) GUANGZHOU 228, B) GUANGZHOU 121

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¶1. (SBU) Summary: Hard times are here - and likely here to stay - for the Pearl River Delta's (PRD's) furniture makers. The industry has been among the most affected by a local business environment that has become less friendly to labor-intensive, export-oriented firms. As with other similarly oriented businesses, furniture firms are in the midst of consolidation, with pressure to make production processes more efficient and shift sales towards more profitable markets. Rising labor costs, currency appreciation, higher inputs costs, and the after effects of U.S. anti-dumping ruling have forced firms to face difficult choices: close shop or re-structure to operate on shrinking profit margins. End summary.

¶2. (SBU) Labor-intensive manufacturing industries that have driven the Pearl River Delta's (PRD) dramatic growth over the past three decades are facing a tough new business environment with rising costs, a more challenging export environment (refs A and B) and a provincial government determined to move forward with its "double transfer" policy. The furniture manufacturing industry has been particularly hard hit. Overall, furniture exports to the U.S. fell 10 percent last year from the year before. Many firms have been forced to shut down. Although no reliable statistic for closures is available, some contacts put the figure in the thousands.

Rising Labor Costs Bring Trouble

¶3. (SBU) China's new Labor Contract Law is the "biggest challenge for the furniture industry in Guangdong," according to Zhang Chengzi, Deputy Secretary General of the Guangdong Furniture Association. Guan Yong Kang of Kinwai International Furniture said that some firms have seen labor costs rise by 10-15 percent since January when the law was first enacted. As a result, some large furniture manufacturers are trying to brand themselves as "less" labor intensive to avoid being subject to government policies aimed at moving such industries out of the PRD. In addition, some manufacturers have strived to enhance worker productivity as a means to reduce labor's percentage of overall costs.

Inputs Costs Rising

¶4. (SBU) Rising inflation has also caused great stress for PRD furniture makers. LacquerCraft, a subsidiary of the Samson Group, which is the largest Chinese furniture exporter to the U.S., raised prices on products in the U.S. for the first time in April 2008 in

order to maintain an operating profit. The firm has seen wood and shipping costs rise dramatically over the last 2 years. With wood costs up, more products are now made with particleboard, which is less expensive and reduces shipping costs because it is lighter. Despite rising costs, most manufacturers will continue importing raw hard woods from the United States and Canada because the quality of wood for production cannot be matched in China or Northeast Asia. However, shipping costs for U.S. and Canadian wood have also risen 40 percent in the last year.

Renminbi Appreciation Adds Heat to the Fire

¶5. (SBU) The rising value of the renminbi has also dealt a harsh blow to PRD furniture manufacturers, which have depended primarily on exports. While the industry has expected the renminbi to appreciate for quite some time, many firms complain that the Chinese monetary policy isn't transparent enough. Several executives told us that they haven't had enough advance notice to re-structure their business models in preparation for renminbi appreciation. However, Kinwai's Guan commented that his firm could benefit from faster appreciation of the renminbi, which would increase its buying power for U.S. forest products. According to Guan, a stronger renminbi would allow the firm to buy more U.S. wood and increase production for both domestic and other overseas markets. Kinwai would seek to continue exporting most output to U.S. markets, while expanding sales to markets in Europe, Asia and especially the Middle East.

Lack of Financing Too

¶6. (SBU) Further complicating the situation facing PRD furniture makers - credit is harder to get. In a recent Shanghai Securities News article, Wang Jue, the small and medium enterprise loan manager of the Guangzhou branch of Shanghai Pufa Bank, said his bank was having a difficult time getting clear and accurate financial records from his furniture industry clients. As a result, the bank had almost zero accounts on record with PRD-based furniture manufacturers. Overall, the bank is now issuing a much smaller number of loans to enterprises in labor-intensive manufacturing. Local media reports have also recently highlighted credit-tightening as a factor that has driven PRD-based furniture manufacturing SME's to apply for loans from "underground banks."

Anti-Dumping Duty Is More than Just a Pinch

¶7. (SBU) PRD furniture manufacturers repeatedly complained to us that the U.S. anti-dumping duty on furniture imports from China is one of the biggest obstacles to maintaining profits and expanding markets. (Note: Wooden bedroom furniture from China has been subject to anti-dumping duties since 2004. End note.) Manufacturers have adopted different strategies to respond to the duty. Some have successfully shifted their focus to domestic Chinese sales, but many PRD furniture manufacturers lack research and marketing experience in the local market. Kinwai's Guan said he expects the duty to rise soon, so his firm is currently negotiating with the U.S. Furniture Association to find a way to mitigate the impact of an increase. Several executives told us that although they understood why the anti-dumping duty was put in place, they felt that the scheme would not help U.S. furniture manufacturers in the long run without additional U.S. subsidies. They argued that most U.S. firms are "less cost efficient" because they use less advanced technology and have fewer workers than their PRD competitors.

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